ISSUE DATE: March 31, 1997

DOCKET NO. E-123/C-95-1085

ORDER RESOLVING DISPUTE BETWEEN UTILITY AND QUALIFYING FACILITY

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Edward A. Garvey	Chair
Joel Jacobs	Commissioner
Marshall Johnson	Commissioner
Mac McCollar	Commissioner
Don Storm	Commissioner

In the Matter of the Complaint of Ann Lanners Against Minnesota Valley Cooperative Light and Power Association

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PROCEDURAL HISTORY

On October 18, 1995 Ann Lanners filed a petition under Minn. Stat. § 216B.164, subd. 5, which authorizes the Commission to resolve disputes between electric utilities and "qualifying facilities," non-public utility power producers encouraged to enter the generation market under the federal Public Utility Regulatory Policies Act, 16 U.S.C. § 824a-3. Ms. Lanners stated she planned to construct a qualifying facility, that Minnesota Valley Cooperative Light and Power Association was legally required to purchase its output, and that Minnesota Valley was refusing to pay the rate set by Minnesota law on grounds that that rate conflicted with federal law.

On November 4, 1995 the Commission solicited comments on the petition from Minnesota Valley and other potentially interested parties.

On December 4, 1995 Minnesota Valley filed comments claiming the rate they were required to pay Ms. Lanners under Minnesota law conflicted with federal law and that Minnesota law was therefore preempted. On December 8, 1995 the Department of Public Service (the Department) filed comments stating it was the Commission's duty to apply Minnesota law. On December 15, 1995 the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG) filed comments stating the issues had not been adequately developed and recommending further filings.

On January 19, 1996 the Commission issued its ORDER ESTABLISHING BRIEFING SCHEDULE, requiring legal briefs from all parties. On March 5, 1996 Minnesota Valley filed its brief. On April 4, 1996 the Department and the RUD-OAG filed their briefs.

The matter came before the Commission on February 13, 1997.

FINDINGS AND CONCLUSIONS

I. Legal and Factual Background

The federal Public Utility Regulatory Policies Act, 16 U.S.C. § 824a-3, encourages cogeneration and small power production by non-utility generators as a matter of national energy policy. The Act was passed in 1978 after a series of national energy crises. It was intended to reduce national dependence on fossil fuels and spur the development of innovative energy technologies by requiring utilities to buy power from non-traditional generators whenever economically feasible.

The Act and its implementing regulations, 18 CFR 292.101 - 292.601, establish standards which cogenerators and small power producers must meet for their facilities to be designated "qualifying facilities." Once a facility becomes a qualifying facility, a public utility must purchase all the electricity it makes available, generally at full "avoided cost," the amount it would cost the utility to generate the electricity itself or secure it elsewhere. 18 CFR 292.304. Responsibility for determining avoided cost and implementing the Act generally has been delegated to state regulatory commissions. 16 U.S.C. § 824a-3 (f), 18 CFR 292.401 - 403. Minnesota has implemented the Act by statute and regulation. Minn. Stat. § 216B.164; Minn. Rules, parts 7835.0100 - 7835.9910. Determining avoided cost is a complex, fact-intensive task normally requiring evidentiary proceedings.

Ms. Lanners is a residential customer who proposes to construct a small wind turbine with a capacity under 40 kW. Minnesota's statute gives her the option of taking payment at the "average retail utility energy rate," instead of going through a proceeding to determine the utility's avoided cost:

> Notwithstanding any provision in this chapter to the contrary, a qualifying facility having less than 40 kilowatt capacity may elect that the compensation for net input by the qualifying facility into the utility system shall be at the average retail utility energy rate. . . .
>
> Minn. Stat. § 216B.164, subd. 3 (c).

Ms. Lanners has chosen that rate, which the Minnesota rules define as follows:

> "Average retail utility energy rate" means, for any class of utility customer, the quotient of the total annual class revenue from sales of electricity minus the annual revenue resulting from fixed charges, divided by the annual class kilowatt-hour sales.
>
> Minn. Rules 7835.0100, subp. 2a.

In practice, the rate Ms. Lanners has chosen would be $0.0608 per kWh, Minnesota Valley's residential rate minus the monthly "customer charge," which is assessed without regard to usage to recover fixed costs. The co-op claims its avoided cost is only $0.010 per kWh.

The federal Act, in requiring the Federal Energy Regulatory Commission (FERC) to enact rules on qualifying facility rates, cautions, "No such rule . . . shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." 16 U.S.C. § 824a-3(b). The Act defines "incremental cost of alternative electric energy" (the formal term for "avoided cost") as follows:

> For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.
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> 16 U.S.C. § 824a-3(d).

II. Positions of the Parties

A. Minnesota Valley

Minnesota Valley originally took the position that Minn. Stat. § 216B.164, subd. 3 (c) is inconsistent on its face with 47 U.S.C. § 824a-3(d) and has therefore been preempted under the Supremacy Clause of the United States Constitution. The co-op pointed to a recent FERC decision, Connecticut Light & Power, No. EL-93-55-000, holding that the federal statute bars the states, as well as the FERC itself, from requiring utilities to pay qualifying facilities more than their avoided costs.

At oral argument Minnesota Valley argued that the Commission need not find the state statute itself unconstitutional but could instead find the manner in which it was being applied in this case preempted under the Supremacy Clause.

B. The Department

The Department emphasized that state statutes enjoy a strong presumption of constitutionality and believed Minn. Stat. § 216B.164, subd. 3 (c) was not preempted for the following reasons:

> (a) It is not settled law that the states are not free to set qualifying facility rates above avoided cost to promote state-specific policy goals;
>
> (b) the Connecticut Light and Power case cited by the co-op is not legally binding on the Commission;
>
> (c) the Commission rule establishing the rate chosen by Ms. Lanners was carefully and successfully crafted to avoid the very constitutional challenge made here;

(d) since Minnesota law requires the co-op's supplier to reimburse it for purchasing power from Ms. Lanners, the co-op is not a real party in interest here and lacks standing to raise the preemption issue.

C. The RUD-OAG

The RUD-OAG argued that preemption was not a constitutional issue in the truest sense and that the Commission was therefore free to reach it despite the general prohibition against administrative agencies deciding constitutional issues. The RUD-OAG argued preemption did not apply for the following reasons:

(a) Congress has not "occupied the field" of promoting cogeneration and small power production, but has left the states the authority to develop their own policies to reflect local conditions;

(b) the co-op has not demonstrated that its avoided cost exceeds the optional rate chosen by Ms. Lanners;

(c) it is not settled law that the states are not free to set qualifying facility rates above avoided cost to promote state-specific policy goals;

(d) the Connecticut Light and Power case cited by the co-op is not legally binding on the Commission, is not directly on point, and is on appeal.

III. Commission Action

The threshold issue in this case is whether the Commission has the authority to decide the preemption issue or must apply state law without regard to the Supremacy Clause claim. If authority is found, the issues are whether the rate sought by Ms. Lanners exceeds Minnesota Valley's avoided cost and, if so, whether federal law preempts Minnesota from requiring the co-op to pay her that rate.

The Commission finds that it has the authority to decide the co-op's "as applied" preemption claim, that the co-op has not demonstrated that the rate Ms. Lanners seeks is higher than its avoided cost, and that the co-op has not demonstrated that preemption would necessarily follow if that rate did exceed avoided cost. These findings are explained below.

A. Commission Authority over Preemption Claims

The Commission has examined its authority to decide federal preemption claims in an earlier case, In the Matter of the Application by the City of Rochester for an Adjustment of its Service Area Boundaries with People's Cooperative Power Association, Inc., E-299,132/SA-93-498. In that case the Commission accepted and adopted the recommendation of the Administrative Law Judge for the reasons set forth in her memorandum,[1] which were in accord with Commission precedent. That approach remains sound and will be followed here.

The Administrative Law Judge found that the Commission's authority to decide preemption claims was limited to claims that statutes were unconstitutional (because preempted) as applied; the Commission could not find a state statute unconstitutional on its face on preemption or any other grounds. She also found that the Commission, like a Minnesota district court, was bound by the preemption decisions of the Minnesota Court of Appeals, unless overturned by the Minnesota Supreme Court. The Commission could not draw upon federal authority to reach a decision in conflict with the Minnesota Court of Appeals.

B. The Co-op Has Not Established that the Alternative Rate Exceeds its Avoided Cost

To succeed on its preemption claim, the co-op must first establish that the rate sought by Ms. Lanners exceeds its avoided cost. The co-op states without documentation or elaboration that its avoided cost is $0.010 per kWh. This statement cannot be accepted at face value.

Determining "avoided cost," the cost a utility would incur to itself provide the energy it purchases from a qualifying facility, is a fact-intensive process. A utility's true avoided cost varies with the amount of energy the qualifying facility (QF) will provide, the reliability and dispatchability of that energy, the length of time for which it will be available, the utility's current capacity and energy costs, its likely need for new capacity during the time the QF will be operating, how it will acquire that capacity, and at what cost. Of course, each of these issues raises a set of sub-issues, which are often litigated at length when large QF's seek to interconnect with utilities.[2]

Given the complexity of determining avoided cost, the Commission does not accept as a fact the co-op's statement that its avoided cost is $0.010 per kWh.

C. It is Not Settled Law that Qualifying Facility Rates Can Never Exceed Avoided Cost

For the co-op to prevail, it must also establish that it is settled law that states may not, under any circumstances, require utilities to pay qualifying facilities more than their avoided costs. This is

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[1] ORDER AFTER RECONSIDERATION (April 24, 1996), referring to Recommended Order on Motion to Dismiss, May 31, 1995.

[2] See, for example, the record in In the Matter of the Petition of Dakota County and Winona County for an Order Resolving Disputes Relating to Purchases by Northern States Power Company of Electric Power from Solid Waste Recovery Facilities, Docket No. E-002/C-88-489, in which attorneys' fees for just one party were approximately $160,000.

not the case.

First, it is important to note that FERC itself assumed for nearly a decade that, although it could not set QF rates over avoided cost, the states were free to do so to promote their own energy policies. As FERC explained in a preamble to rules promulgated in 1980:

> If a State program were to provide that electric utilities must purchase power from certain types of facilities, among which are “qualifying facilities,” at a rate higher than that provided by these rules, a qualifying facility might seek to obtain the benefits of that State program. In such a case, however, the higher rates would be based on State authority to establish such rates, and not on the Commission’s rules.[3]

FERC has now reversed this position and interprets 16 U.S.C. § 824a-3(d) to prohibit states from exercising this authority. It is not self-evident, however, that FERC’s new interpretation is superior to the old or that it will be given more credence by the courts. It is possible, for example, that FERC will be required to initiate rulemaking under the federal Administrative Procedure Act before it can change its longstanding interpretation of the federal statute.

It is also possible that FERC’s new interpretation of the statute will be rejected. The Public Utility Regulatory Policies Act was clearly intended to create a federal/state partnership to explore new directions in federal and state energy policy. The Act preserved a large role for state regulation and policymaking. Congress clearly intended to give states the ability to respond to local conditions and to give federal policymakers the benefit of observing state experience with diverse approaches.

[3] 45 Fed. Reg. 12,221 (Feb. 25, 1980).

How far state authority extends has been subject to debate and is far from settled. Two state supreme courts have reached opposite conclusions on whether states may require utilities to pay QF rates exceeding avoided cost,[4] and the United States Supreme Court has so far declined to take up the issue.[5] It is by no means clear, then, that FERC's new interpretation of 16 U.S.C. § 824a-3(d) is correct.

D. FERC's Connecticut Light and Power Decision is Not Binding on This Commission and is Not Directly on Point

It is of course important to note that the FERC decision on which the co-op relies, Connecticut Light and Power, is not binding on this Commission. It is a declaratory Order not even binding on the parties directly affected without judicial action.

Neither are the facts of Connecticut Light and Power particularly close to the facts in this case. Connecticut Light and Power involved a very large qualifying facility and substantial utility expenditures. Ms. Lanners' facility is very small, and the amount of money in dispute, according to the utility, is $300 to $500 per year.

Connecticut Light and Power involved a state statute requiring payment of the full retail rate, which was understood and admitted to exceed avoided cost. This case involves a rule requiring payment of the retail rate minus fixed charges, a calculation explicitly designed to yield a reasonable proxy for avoided cost.

In short, even if Connecticut Light and Power were binding on this Commission, the factual differences between the two cases could prevent a finding of preemption in this case.

E. Minnesota's Formula for Setting Rates for Small Qualifying Facilities is a Reasonable Method of Approximating Avoided Costs for Very Small Qualifying Facilities and a Reasonable Method of Promoting a Legitimate State Goal

The federal Act is intended to promote alternative energy generation and to prod states into doing the same. Minnesota's decision to encourage the development of very small qualifying facilities by setting stable and predictable rates as close to avoided cost as possible was well

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[4]See In re Consolidated Edison Company of New York, Inc. v. Public Service Commission of State of New York, 472 N.E.2d 981 (N.Y. 1984) and Massachusetts Electric Co. v. Massachusetts Dept. of Pub. Util., 643 N.E.2d 1029 (Mass. 1994, both holding states may set QF rates above avoided cost, and Kansas City Power & Light Co. v. Kansas Corp. Comm'n., 676 P.2d 764 (Kan. 1984), holding states may not.

[5]Consolidated Edison Co. v. Public Service Commission of New York, 470 U.S. 1075 (1985).

within the purposes of the Act. It would contravene the purposes of the Act to hold that Minnesota must require very small QF's to choose between a full-blown avoided cost proceeding or accepting whatever the utility claimed was its avoided cost for the facility at issue.

In fact, FERC itself has recognized the impracticality of determining precise avoided cost for facilities under 100 kW and has required the development of standard rates for such facilities. 18 C.F.R. § 292.304 (c). The Minnesota rule establishing standard alternative rates for QF's under 40 kW is much the same thing.

It is also important to note that when the Commission promulgated Minn. Rules 7835.0100, subp. 2a, setting alternative rates for very small QF's at retail rates minus fixed charges, it was trying to develop a reasonable proxy for avoided cost.[6] The fact that the proxy may not equal the result of a full scale avoided cost proceeding in every case does not invalidate the effort, any more than FERC-mandated standard rates are invalid for the same reason. In both cases the public interest in encouraging small power providers to enter the market outweighs the public interest in precision in determining avoided cost.

Finally, it should be noted that Minnesota Valley is not a rate-regulated utility. It set its own customer charge, the fixed charge the Minnesota rule uses as a proxy for unavoidable costs, thereby setting its own rate for power purchased from very small QF's. The co-op, then, is uniquely unsuited to raise the claim that Minnesota law is forcing it to pay QF rates exceeding its avoided cost.

F. Conclusion

For the reasons set forth above the Commission concludes it should require Minnesota Valley to pay Ms. Lanners the rate established in accordance with Minn. Stat. § 216B.164, subd. 3 (c) and Minn. Rules 7835.0100, subp. 2. The Commission will so order.

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[6] In the Matter of the Proposed Adoption of Amendments to the Rules of the Minnesota Public Utilities Commission Governing Cogeneration and Small Power Production, Docket No. E-999/R-84-105, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER ADOPTING RULES (October 16, 1984).

ORDER

1. The Commission finds that Minnesota Valley Cooperative Light and Power Company must pay the qualifying facility at issue rates calculated in accordance with the provisions of Minn. Stat. § 216B.164, subd. 3 (c) and Minn. Rules 7835.0100, subp. 2.

2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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